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November 1, 2013

Ms. Bridget C. Bohac
Chief Clerk
P.O. Box 13087
Austin, TX 78711-3087

Re: Compensation related to Petition for Special Expedited Release Pursuant to Texas Water Code Section 13.254 (a-5) and (a-6)—EB Windy Hill LP (Landowner) and Monarch Utilities I L.P. (Decertified Utility)

Dear Ms. Bohac:

This letter brief is filed on behalf EB Windy Hill LP ("EB Windy Hill" or "Landowner") regarding the determination of compensation, if any, due to Monarch Utilities I, LP ("Monarch") related to the 445 acre tract of land owned by EB Windy Hill (the "Property") which has been decertified from Monarch's water CCN in Hays County, Texas.

The Statutory Framework for Determining Compensation to Monarch.

It is important to understand that the TCEQ's order earlier this year decertifying Monarch's CCN over the EB Windy Hill Property did not divest Monarch of any property right. TCEQ Rule 291.113 (a) provides in relevant part:

> A certificate or other order of the commission does not become a vested right and the commission at any time after notice and hearing may revoke or amend any certificate of public convenience and necessity (CCN)...

Accordingly, the revocation of Monarch's CCN does not automatically give rise to a right of compensation. Instead the compensation associated with revocation of Monarch's CCN over the EB Windy Hill Property is purely a creation of statutory law. Accordingly, it is important to understand the purpose of the statutory compensation framework in determining the amount of compensation.

Section 13.254 (d), Water Code, specifies the purpose of the compensation:

> (d) A retail public utility may not in any way render retail water or sewer service

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directly or indirectly to the public in an area that has been decertified under this section ***without providing compensation for any property that the commission determines is rendered useless or valueless*** to the decertified retail public utility as a result of the decertification. [Emphasis added.]

Without doubt, this is the sole purpose of the compensation: **to determine the value of property rendered useless or valueless to the utility**.

The term "useless" means "not fulfilling or not expected to achieve the intended purpose or desired outcome." The term "valueless" means "having no value; worthless."

Determining the compensation for real property rendered useless or valueless.

Section 13.254 (g), Water Code, specifies two different processes for determining compensation for *property rendered useless or valueless*: one for real property and the other for personal property. The statute says:

"(g) For the purpose of implementing this section, the value of **real property** owned and utilized by the retail public utility for its facilities shall be determined according to the standards set forth in Chapter 21, Property Code, governing actions in eminent domain and the value of **personal property** shall be determined according to the factors in this subsection. …" [Emphasis added.]

If any real property of Monarch has been *rendered useless or valueless*, then the parties are required by the statute to address the value of that real property using the criteria in eminent domain law in Chapter 21, Property Code. In fact, neither party's appraisal report identifies any specific real property of Monarch which has been *rendered useless or valueless* and, therefore, neither party presented an analysis of Monarch's real property assets using the standards set forth in Chapter 21, Property Code.

Determining the compensation for personal property rendered useless or valueless.

The statute specifies that compensation for **personal property** *rendered useless or valueless* is to be determined using the factors in Section 13.254 (g), Water Code, which lists seven different factors to be used in determining compensation for personal property *rendered useless or valueless*. EB

Windy Hill's report provides a detailed engineering analysis demonstrating that no personal property of Monarch will be *rendered useless or valueless*. In doing so, EB Windy Hill's report focused on the Monarch water assets related to the Plum Creek water system since removing the EB Windy Hill Property from Monarch's Plum Creek water service area cannot *render useless or valueless* any facilities of Monarch that provide water to other areas of the state (like north or east Texas). Those other water facilities are not designed and used to provide water service to the Windy Hill Property and physically cannot be used for such purposes. Likewise, since Monarch provides only water service to the Plum Creek service area where the EB Windy Hill Property is located, Monarch's sewer property around the State of Texas cannot be *rendered useless or valueless* by the decertification of the Property.

In spite of the facts that (i) Monarch water assets serving other parts of the state cannot possibly *be rendered useless or valueless* by the decertification of Windy Hill's Property and (ii) no Monarch sewer facilities could be *rendered useless or valueless* by the decertification of the Property, Monarch's report nonetheless utilized an approach (for example in analyzing Factor 1-Debt Allocation) that includes *all* of Monarch's facilities statewide (both water and sewer facilities) in determining compensation for facilities rendered useless or valueless caused by the decertification of the Property, even though the vast majority of those facilities are not used in providing water service to the Plum Creek service area and could not possibly be rendered useless or valueless by decertification of Wind's Hill's property.

Monarch's report assumes in Factor 1 that all of Monarch's facilities in the Plum Creek service area should be considered to have been rendered in some way useless or valueless. But Monarch fails to analyze which specific facilities have been rendered useless or valueless. In fact, the record in this proceeding reflects that:

1. Monarch never obtained a supply of water for the Property;
2. Monarch never built the 250,000 gallons of elevated storage needed to serve the Property; and
3. Monarch never built the transmission lines needed to serve the Property.

Thus, no property has been rendered useless or valueless.

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For example, in Monarch's analysis of Factor 1 (allocation of Monarch's debt service costs to the Property), Monarch's analysis fails to identify what part of that debt is related to "*property rendered useless or valueless*" to Monarch. Instead, Monarch's analysis concludes that $204,100 of Monarch's debt should be allocated to the Property, not because it is related to *property rendered useless or valueless* to Monarch, but rather because of the following thought process as contained on page 3 of Monarch's appraisal report:

> "Monarch's existing statewide customers share equally in the cost of water debt service payments. Thus we believe it is reasonable to pro rate the debt service costs among all Monarch's customers and assume the revenue lost from the [Property] (had it remained within the Plum Creek CCN) will have to be made up by the existing customers."

Clearly, no attempt was made to allocate the debt on the basis of what personal property of Monarch was *rendered useless or valueless*; instead, all of Monarch's property (both personal property and, for that matter, real property and both water and sewer assets) was included in the analysis by its appraise. Thus, while purporting to use the seven factors listed in Section 13.254 (g), Water Code, to determine compensation due Monarch, the critical failure in the analysis contained in Monarch's report is that it ignores the overriding purpose of the compensation factors: to determine the value of *property rendered useless or valueless*.

This flawed approach enables Monarch to somehow demand $3.9 million from EB Windy Hill for compensation in spite of the fact that Monarch has no water supply for the Property and has not constructed the necessary elevated storage tank and transmission facilities to serve the Property. In truth, the removal of the EB Windy Hill Property from the CCN will not render any Monarch property useless or valueless because Monarch's facilities were not built to, and are not adequate to, serve future growth. In fact, there is abundant evidence that Monarch's Plum Creek utility system does not even meet minimum TCEQ standards to provide service to existing customers. Thus, not only did Monarch not build any facilities to serve EB Windy Hill's Property, the existing customers of Monarch's Plum Creek water service area have repeatedly complained over the last ten years of insufficient pressure, brown water, leaking storage tanks, lack of fire flow and other complaints. Real estate agents in the area even discourage new homebuyers from building in areas served by Monarch because its system is inadequate and its rates too high.

Monarch Has Never Obtained a Supply of Water for the Property.

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Public records obtained and provided to the TCEQ during this decertification process by EB Windy Hill, but never offered by Monarch, demonstrate that *Monarch has never obtained any water supply to serve the Property*. Monarch has two sources of water: (i) surface water from the GBRA contract and (ii) Edwards Aquifer well water from wells located in the Barton Springs Edwards Aquifer Groundwater Conservation District ("BSEAGCD").

Both parties agree (in their respective analyses of Factor 4) that Monarch does not use the GBRA water to supply future growth like that planned in the Property; instead that supply is for base flow for existing customers and neither party allocated any of its costs to the compensation being considered in this case.

Further, public records provided by EB Windy Hill reflect that none of Monarch's well water is even permitted to serve the EB Windy Hill Property. The relevant permit from the Barton Springs Edwards Aquifer Groundwater Conservation District ("BSEAGCD") to review is the "transport permit." The transport permit for the well water is required in order to serve the Property (again, known as the Phillips Ranch) *because the Phillips Ranch Property is located outside the boundaries of the BSEAGCD*. However, *the Phillips Ranch Property is specifically excluded from the area where the well water can be used*.

Further, the transport permit states that if Monarch wants to provide water from its four wells to Phillips Ranch, *Monarch must first notify the BSEAGCD and seek a major amendment to the transport permit*. *Monarch has never notified the BSEAGCD that Monarch intends to apply for an amendment to add the Property (Phillips Ranch) to Monarch's transport service area*.

Finally, the transport permit allows *only 50,000,000 gallons per year* to be used outside the boundaries of the BSEAGCD. That amount translates to a supply of 0.137 MGD or 95 gallons per minute. At minimum standards of 0.6 gpm per connection, even if that amount of water could be used to supply the Property, it would only serve 158 LUEs. Even if the Property is added to the transport area, that amount water would not even get the development of the Property started.

In sum, it is clear that **Monarch does not have an adequate water supply for the Property** and

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never secured an adequate water supply for the Property. There are no "stranded" water supply costs since Monarch simply never obtained any water supply for the Property.

Monarch Has Not Built Elevated Storage to Serve the Property. The story is much the same for elevated storage. Monarch claims that it has constructed elevated storage sufficient to provide service to the Property (again, known as the Phillips Ranch). Monarch's own planning documents, and the information it has filed with the Commission in this compensation process, clearly demonstrate to the contrary. Monarch's own Water System Planning Report states that "*in order to provide elevated storage for service to Phillips Ranch, Monarch must construct an additional 250,000 gallons of elevated storage*." The 250,000 gallons of additional elevated storage would be *in addition to* the Monarch's two existing 500,000 gallon elevated storage tanks discussed in Monarch's compensation appraisal report and discussed in the two letters filed with the Commission in this compensation process by Monarch. What Monarch failed to disclose, however, is that the additional 250,000 gallon storage tank needed (per Monarch's own Master Plan) *has never been constructed*.

Monarch Has Not Built the Needed Water Transmission Facilities to Serve the Property.

Again, the story is similar for water transmission facilities. Monarch's own planning report states that Monarch needed to construct a water transmission line to serve the Property; yet, Monarch has not constructed that line. Both parties agree that ***this transmission line has NOT been built***.

The Compensation Factors. In light of this statutory and factual overlay, EB Windy Hill submits these comments on the compensation factors.

Factor 1 The amount of the retail public utility's debt allocable for service to the area in question.

Any allocation of Monarch's debt to the Property is properly denied for at least two reasons.

First, Monarch failed to file with TCEQ the data related to Monarch's debt that Monarch is required by 30 TAC Section 291.113 (q) to file prior to submitting its compensation appraisal report. That regulation states:

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(q) Within ten calendar days after receipt of notice that a decertification process has been initiated, a retail public utility with outstanding debt secured by one or more liens shall:

(1) submit to the executive director a written list with the names and addresses of the lienholders and the amount of debt; and

(2) notify the lienholders of the decertification process and request that the lienholder provide information to the executive director sufficient to establish the amount of compensation necessary to avoid impairment of any debt allocable to the area in question.

Monarch apparently sought to justify its failures to comply with TCEQ rules by deceptively asserting that "No liens have been *perfected* on Monarch's assets; therefore, no notice was necessary under [TCEQ Rule 30 TAC Sec. 291.113 (q)]." [Emphasis added.] The TCEQ rule, however, addresses *any liens*, perfected or otherwise. EB Windy Hill presented documents from the Texas Secretary of State UCC Database unequivocally establishing that Monarch is a debtor, and that COBANK, ACB is a secured party. These instruments conclusively establish that COBANK has a lien on Monarch assets.

The second, and more fundamental, reason to deny this compensation is that Monarch's allocation of over $28,000,000 of debt for Monarch's total water and wastewater system assets back to the Property is inappropriate because Monarch's analysis utterly fails to allocate that debt to specific facilities in the Plum Creek water service area that have been ***rendered useless and valueless***. Again, rather than analyzing what facilities have been rendered useless or valueless, the approach Monarch used in analyzing Factor 1 fails to include any analysis of what portion of that debt (which again is for all of Monarch's statewide water and sewer systems) is properly allocable to wastewater facilities, what part is properly allocable to water facilities serving other portions of Monarch service areas, and what part is properly allocable to existing customers in the Plum Creek service area that have been **rendered useless and valueless**. Instead, in Factor 1, Monarch simply looks at its entire system (wastewater and other water system assets) as used and useful in providing service to the Property. In fact, those specific assets do not serve the Property and therefore could not be rendered useless and valueless by decertification of the Property.

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Factor 2 The value of the service facilities of the retail public utility located within the area in question.

Monarch's compensation appraisal report (and the report of the third party appraiser) agree with that of the EB Windy Hill that no service facilities of Monarch located within the area are subject to compensation under the statute.

Factor 3 The amount of any expenditures for planning, design, or construction of service facilities that are allocable to service to the area in question.

Again, Monarch's analysis of this factor fails to look specifically at any facilities *rendered useless or valueless* and instead Monarch again just assumes that all facilities owned by Monarch in its Plum Creek water system somehow have some capacity that is *rendered useless and valueless* by decertification of the Property. Accordingly, Monarch simply assigns to the Property a portion of the cost of each component of Monarch's system regardless of whether a specific facility in fact has been *rendered useless or valueless*. In other words, Monarch's analysis fails to identify any specific facilities rendered useless or valueless.

By lumping all of Monarch's facilities costs together, Monarch ignores the fact that many of Monarch's facilities have nothing to do with serving water to the Property. Examples of facilities that could not possibly be rendered useless or valueless by removal of the Property are (i) the GBRA water supply, (ii) the wells and well water supply and (iii) Monarch's elevated storage facilities. That only leaves transmission lines that need to be looked at.

Contrary to Monarch's global approach that fails to identify any facility *rendered useless or valueless*, EB Windy Hill's compensation appraisal report looks at each of Monarch's individual facilities and demonstrates that none will be *rendered useless or valueless*.

Factor 4 The amount of the retail public utility's contractual obligations allocable to the area in question.

Monarch's compensation appraisal report properly addresses this factor. In its analysis, Monarch

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concludes that none of the GBRA contract costs should be allocated to the Property because it is "fully utilized by existing customers." This is the only place where Monarch's report uses the proper approach in analyzing whether any part of the GBRA water supply contract will be **rendered useless or valueless**. Hence, Monarch and EB Windy Hill agree allocation for this factor should be $0.00 because of the simple fact that the contract has not been **rendered useless or valueless**.

Factor 5 Any demonstrated impairment of service or increase of cost to consumers of the retail public utility remaining after the decertification. Murfee Engineering's supplemental analysis submitted along with this document addresses this issue. Reference is made to it. Murfee Engineering has not changed its prior recommendation of $0 for this factor.

Further, it should be noted that Monarch's reasoning to support its claim under this factor for over $700,000 is inconsistent with the intent of the compensation statute and would bestow a windfall on Monarch. Monarch's claim of over $700,000 rests on the premise that if, indeed, there is any increase in the per-LUE cost of future transmission improvements, Monarch will have to pay it and pass it on to its consumers. But, that could never be the case. Monarch's tariff line extension policy clearly says that all such costs are costs to be paid by the developer, not the consumer. Thus, the consumers cannot be impacted by increased developer line costs. Monarch's claim for this factor should be denied. The explicit purpose of the statute is to compensate a CCN holder for property rendered useless or valueless not to compensate a CCN hold for developer facilities that have not been built, and that existing customers will not fund.

Further, the third party appraiser's report includes the cost of future transmission facilities to provide not only water service meeting TCEQ minimum standards, but also fire flow. At the time this process was initiated, Monarch was not under any obligation to provide fire flow. Fire flow costs should not be included in the compensation analysis. The third party appraiser's report does so and should be rejected for that reason.

Factor 6 The impact on future revenues lost from existing customers. Both Monarch and the third party appraiser properly analyze this factor. It is $0 since there are no "existing" customers on the Property. Unfortunately, as discussed below in Factor 8, Monarch attempts an end-run on this factor by trying to get $2,266,000 for lost revenues from "future customers" on the Property Monarch

cannot now serve and has never been in a position to serve due to lack of water supply and infrastructure. See the discussion in Factor 8 below.

Factor 7 Necessary and reasonable legal expenses and professional fees. The amount of these expenses is a matter of judgment. EB Windy Hill LP believes that Monarch's alleged expenses accepted by the third party appraiser are excessive for the reasons previously provided by EB Windy Hill in its appraisal report.

Factor 8. Other Relevant Factors. Monarch's compensation appraisal report claims an astounding $2,266,600 for the "market value of the Windy Hill Tract…based on future returns to the investors (profits) expected from water sales in the proposed development."1 And, again, this extraordinary claim is made by Monarch in spite of the fact that Monarch (i) has no water to serve the Property, (ii) has not constructed the elevated storage to serve the Property (iii) has not constructed the transmission line to get water to the Property, and (iv) the Legislature explicitly removes from the statute compensation for lost future revenues.

This claim is an attempt by Monarch to claim lost revenues from future (not existing) customers who might have moved onto the EB Windy Hill Property. Prior to 2005, Monarch might have been able to assert some sort of claim for lost future profits from future (as opposed to existing) customers on the EB Windy Hill Property because before September 1, 2005, Section 13.254 (g) provided in regard to Factor 6 that Monarch could have been compensated for "the impact on future revenues and expenses of the retail public utility." However, in 2005, the Texas Legislature adopted HB 2876 which amended Section 13.254 (g) effective September 1, 2005), and Factor 6 was changed to allow compensation only for "the impact on future revenues lost from *existing* customers." Thus, the Legislature has clearly spoken: no compensation can be had for revenues lost from future customers; only revenues lost from existing customers can be compensated. Monarch's analysis is a blatant attempt to circumvent the Legislature's will.

Finally, Monarch's claim for over $2.2 million for "lost future profits" flies in the face of clear Texas law that the CCN rights taken from Monarch are not vested rights. Again, see 30 TAC

1 See page 11 of Monarch's compensation appraisal report, third paragraph.

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291.113 (a).

For these reasons, Monarch is not entitled to any compensation under Factor 8.

In sum, EB Windy Hill believes its compensation analysis is correct and the Commission should approve it.

EB Windy Hill appreciates the opportunity to provide this letter brief. A copy of this letter brief is being provided to Monarch Utilities I, L.P. and its attorneys, the TCEQ staff, the City of Kyle and the third party appraiser by certified mail, return receipt requested as shown in the certificate of service below.

Thank you,

Ronald J. Freeman

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Enclosures

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Certificate of Service

I certify that a copy of the foregoing letter together with all attachments described therein were mailed by United States mail, postage prepaid on November 1, 2013, to Monarch Utilities I LP at its address of record according to TCEQ records, being 12535 Reed Road, Sugar Land, Texas 77478-2837 and to its attorneys, Lloyd Gosselink Rochelle & Townsend PC at their address shown above in this letter, and to the other persons listed as cc's in the letter attached hereto.

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